

Message Text

CONFIDENTIAL

PAGE 01 QUITO 08423 01 OF 03 021324Z

53

ACTION ARA-10

INFO OCT-01 ISO-00 SP-02 USIA-06 AID-05 EB-07 NSC-05

CIEP-01 TRSE-00 SS-15 STR-04 OMB-01 CEA-01 L-03 H-02

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AGR-05 /107 W

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R 012237Z DEC 76

FM AMEMBASSY QUITO

TO SECSTATE WASHDC 2399

C O N F I D E N T I A L SECTION 1 OF 3 QUITO 8423

JOINT STATE/AID MESSAGE

E.O. 11652: GDS

TAGS: ECON, EFIN, PFOR, EAID, EGEN, EC

SUBJECT: ECONOMIC-DEVELOPMENT POLICY DECISIONS FACING GOE:
DESIRABILITY OF EXTERNAL GUIDANCE

REF: QUITO 8422

1. SUMMARY: THIS EMBASSY SEES A STRONG POSSIBILITY,
NOW THAT THE PETROLEUM BOOM IN ECUADOR HAS LEVELED OFF,
THAT GOE POLICY CHOICES WILL RESULT IN A RETURN TO THE
LOW RATE OF GROWTH OF THE 1050S AND 1960S. WE SEE THE
NEED, THEREFORE, FOR A GREATER INVOLVEMENT IN ECUADOR
BY INTERNATIONAL LENDING INSTITUTIONS IN ORDER TO PROMOTE
POLICIES MORE APPROPRIATE TO ECUADOR'S DEVELOPMENT NEEDS.
THE OPPORTUNITY FOR A MORE ACTIVE ROLE FOR EXTERNAL
LENDERS WILL SOON BE PRESENTED BY THE GOE'S REQUEST FOR
AN IBRD CONSULTATIVE GROUP. U.S. AGENCIES WILL BE FACED
WITH A DECISION AS TO WHETHER THE USG SHOULD SUPPORT THE
FORMATION OF SUCH A GROUP. IN A SEPARATE MESSAGE THE
EMBASSY DEALS WITH THIS ISSUE IN THE LIGHT OF U.S. IN-
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PAGE 02 QUITO 08423 01 OF 03 021324Z

TERESTS #343. THE PRUPOSE OF THIS MESSAGE IS TO PROVIDE

U.S. AGENCIES WITH A GENERAL BUT HIGHLY SYNTHESIZED PERSPECTIVE ON THE IMPORTANT VARIABLES THAT WILL DETERMINE WHERE THE ECUADOREAN ECONOMY IS GOING IN THE NEXT DECADE OR SO. (THE MESSAGE IS A SUMMARY OF AN ANALYSIS RECENTLY PREPARED BY THE ASSISTANT USAID DIRECTOR.) AS IS THE CASE WITH MOST LDCS, IMPORT CAPACITY IS CRUCIAL TO ECUADOR'S GROWTH, AND MORE ADEQUATE EXPORT PERFORMANCE SHOULD BE THE PRINCIPAL OBJECTIVE OF GOE POLICY. IN THE FORESEEABLE POLITICAL ENVIRONMENT, MORE EQUAL DISTRIBUTION OF INCOME CAN ONLY BE A PRODUCT OF A HIGHER RATE OF, AND BETTER FOCUSED, INVESTMENT. IF LEFT TO THEIR OWN DEVICES, HOWEVER, ECUADOREAN POLICYMAKERS ARE MORE LIKELY THAN NOT TO CONTINUE TO FOLLOW POLICIES WHICH WILL NOT PROVIDE THE NECESSARY STIMULANT TO EXPORTS OR TO AN ADEQUATE PATTERN OF INVESTMENT. END SUMMARY.

2. THE TWO PRINCIPAL PROBLEMS WITH WHICH ECUADOREAN DECISION-MAKERS MUST CONCERN THEMSELVES ARE OVERALL ECONOMIC GROWTH (GNP) AND THE DISTRIBUTION OF INCOME. ECUADOR HAS ONLY RECENTLY MOVED UP FROM BEING ONE OF THE POOREST LA COUNTRIES TO ONE IN THE LOWER MIDDLE RANGE, THANKS TO THE DISCOVERY AND EXPLOITATION OF CRUDE PETROLEUM RESOURCES DURING THE LAST EIGHT YEARS. STILL, PER CAPITA GNP IS ONLY ABOUT \$525. ECONOMIC GROWTH IN THIS HIGHLY STRATIFIED SOCIETY IS A PRE-REQUISITE FOR ACHIEVING A MORE EQUAL DISTRIBUTION OF INCOME THROUGH PEACEFUL MEANS.

3. IN A SIMPLE ECONOMY LIKE THAT OF ECUADOR, GNP GROWTH IS DIRECTLY CORRELATED WITH THE GROWTH OF GENERAL IMPORT CAPACITY. ECUADOR IS A SMALL COUNTRY WITH ABUNDANT AND VARIED RESOURCES IN AGRICULTURE, SOME CRUDE PETROLEUM AND NATURAL GAS, NO COAL AND INSIGNIFICANT METALLIC RESOURCES. IT IS, BY TRADITION AND BY NECESSITY, AN OPEN ECONOMY. IMPORTS ARE REQUIRED AS RAW MATERIAL OR SEMI-MANUFACTURED INPUTS INTO THE PRODUCTION PROCESS, AS CAPITAL GOODS AND AS CONSUMPTION GOODS THAT CANNOT BE GROWN OR MANUFACTURED DOMESTICALLY FOR REASON OF CLIMATE, OR PRODUCTION AND SCALE REASONS. IN

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PAGE 03 QUITO 08423 01 OF 03 021324Z

ORDER TO FINANCE A GROWING LEVEL OF IMPORTS, THE ECONOMY MUST CONTINUALLY INCREASE ITS EXPORTS. ECUADOR CAN AND SHOULD EXPAND ITS EXTERNAL BORROWING BUT COMMERCIAL AND DONOR CREDITS ARE ONLY A TEMPORARY SUBSTITUTE FOR GROWTH OF EXPORT EARNINGS, SINCE VENTUALLY THE LOANS MUST BE PAID FOR. FURTHER, SPECIALIZED LOANS DO NOT PROVIDE THE GENERAL IMPORTING CAPACITY NEEDED BY THE PRIVATE SECTOR.

4. EXCEPT FOR THE AGRICULTURAL AND PETROLEUM SECTORS, ECUADOR'S ABILITY TO INCREASE EXPORT ACTIVITY IS CURRENTLY RESTRAINED BY GOE POLICIES AND EXTERNAL FACTORS.

(PETROLEUM WILL BE DISCUSSED BELOW.) WITH THE EXCEPTIONS OF BANANAS, ECUADOR COULD RATHER READILY INCREASE THE VOLUME AND EARNINGS OF ITS TRADITIONAL AGRICULTURAL EXPORTS. ECUADOR IS THE ORIGIN OF ABOUT ONE-THIRD OF THE BANANAS IN WORLD TRADE, AND WORLD BANANA DEMAND SEEMS TO BE INELASTIC BOTH WITH RESPECT TO INCOME AND PRICE. HOWEVER, OTHER TRADITIONAL TROPICAL AGRICULTURAL EXPORTS SUCH AS COFFEE AND CACAO ARE LIKELY TO BE MUCH MORE ELASTIC IN DEMAND FOR ECUADOR THAN BANANAS BECAUSE WORLD CONSUMPTION IS MUCH MORE SENSITIVE TO PRICE AND BECAUSE ECUADOR ACCOUNTS FOR A RELATIVELY SMALL SHARE OF WORLD SUPPLY. IT IS ALSO LIKELY THAT ECUADOR COULD, WITH ADEQUATE PRODUCTION INCENTIVES AND EXCHANGE RATE POLICIES, EXPORT OTHER AGRICULTURAL PRODUCTS WHICH ARE NOT NOW IMPORTANT EXPORTS, SUCH AS RICE, HARD CORN, CATTLE, SOYA AND PALM OIL. THUS, AN AGGRESSIVE EXPORT (READ: EXCHANGE RATE) POLICY COULD RESULT IN INCREASED EARNINGS FROM CROPS OTHER THAN BANANAS. BECAUSE ECUADOR'S AGRICULTURAL SECTOR DOES NOT DEPEND ON WORLD-TRADED INPUTS TO A SIGNIFICANT EXTENT, APPROPRIATE EXCHANGE-RATE ADJUSTMENTS COULD MAKE ECUADOREAN AGRICULTURAL PRODUCTION MORE COMPETITIVE IN THE WORLD MARKET.

5. SINCE WORLD WAR II, EXCEPT FOR THE RECENT YEARS OF THE OIL EXPORT BANANZA, ECUADOR HAS MAINTAINED AN OVERVALUED EXCHANGE RATE SUBJECT TO INFREQUENT AND INADEQUATE DEVALUATIONS. TO DEFEND THE RATE, THE

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PAGE 04 QUITO 08423 01 OF 03 021324Z

AUTHORITIES HAVE RESORTED TO QUALITATIVE AND QUANTITATIVE IMPORT CONTROLS AND OCCASIONAL EXPORT SUBSIDY SCHEMES. A PARALLEL OR FREE FOREIGN EXCHANGE MARKET WAS GENERALLY RESERVED FOR INVISIBLES, BUT AS THE OFFICIAL AND FREE MARKET RATES DIVERGED AN INCREASING SHARE OF GOODS TRANSACTIONS WAS SHIFTED TO THE FREE MARKET. THE PRIME TARGET OF THE COUNTRY'S ECONOMIC AUTHORITIES HAS BEEN THAT OF MAINTAINING THE VALUE OF THE SUCRE WITH RESPECT TO THE DOLLAR. FAILURE TO DO SO HAS BEEN VIEWED BY THE ECUADOREANS AS A MUCH GREATER PERIL THAN FAILURE TO ACHIEVE A COMFORTABLE RATE OF GNP GROWTH. THUS, THROUGHOUT THE FIFTIES AND MOST OF THE SIXTIES, ECUADOR'S PER CAPITA GNP GROWTH RATE REMAINED BELOW THE MODEST 2.5 PERCENT TARGET OF THE ALLIANCE FOR PROGRESS. YET QUITO'S LEADING NEWSPAPER

COULD, FIVE YEARS AFTER THE LAST DEVALUATION, ARGUE THAT THE 1970 DEVALUATION WAS INCORRECT AND IMMORAL AND SHOULD BE REVERSED. AND THE "ECONOMIC TEAM" JUST INSTALLED HAS EMPHATICALLY DECLARED ITS INTENTION OF MAINTAINING THE CURRENT EXCHANGE RATE.

6. THE DISTRIBUTION OF INCOME IN ECUADOR IS NOTORIOUSLY UNEQUAL, AND A CONTINUING MOVE TOWARD A MORE EQUAL DISTRIBUTION OF INCOME COULD AFFECT THE FUTURE OF THE ECONOMY IN THREE WAYS. THESE ARE EQUITY, ALLOCATIVE EFFICIENCY IN PRODUCTION, AND THE CREATION OF A RELATIVELY BROAD-BASED MARKET. EQUITY IS THE MOST COMPELLING OF THESE REASONS. YEARS OF SPANISH COLONIAL AND CREOLE OLIGARCHIC DOMINATION HAVE RESULTED IN A DUAL SOCIETY IN WHICH MOST OF THE RURAL POPULATION (SIXTY PERCENT) LIVE IN CONDITIONS LITTLE TOUCHED BY THE TWENTIETH CENTURY. THE PRIMARY DISTRIBUTIONAL PROBLEMS ARE THE UNEQUAL DISTRIBUTION OF LAND, THE INADEQUATE RATE OF CREATION OF SIGNIFICANT EMPLOYMENT OPPORTUNITIES, AND THE GENERAL LOW PRODUCTIVITY OF THE ECUADORIAN FARMER AND WORKER.

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PAGE 01 QUITO 08423 02 OF 03 021337Z

53

ACTION ARA-10

INFO OCT-01 ISO-00 SP-02 USIA-06 AID-05 EB-07 NSC-05

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R 012237Z DEC 76

FM AMEMBASSY QUITO

TO SECSTATE WASHDC 2400

C O N F I D E N T I A L SECTION 2 OF 3 QUITO 8423

7. PROGRESS IN MEETING THE INCOME DISTRIBUTION PROBLEM

IN ECUADOR DEPENDS ON TWO FACTORS: FIRST, BY AN INCREASED RATE OF JOB CREATION AND A GENERAL, WIDESPREAD INCREASE IN LABOR PRODUCTIVITY, AND SECOND, BY A CONSCIOUS PROGRAM OF INCREASED INVESTMENT IN, AND ON BEHALF OF, THE RURAL PEOPLE THROUGH THE EFFECTIVE EXTENSION TO THEM OF THE EDUCATION SYSTEM, HEALTH SERVICES AND AGRICULTURAL RESEARCH/OUTREACH. THESE VARIABLES DEPEND ON THE RATE AND QUALITY OF INVESTMENT. LAND REDISTRIBUTION, ALTHOUGH PERHAPS IMMEDIATELY DESIRABLE FROM AN EQUITY VIEW, IS NOT CONSIDERED LIKELY NOR PRODUCTIVE DUE TO LACK OF MANAGEMENT AND RISK-BEARING ABILITY ON THE PART OF THE BENEFICIARIES. LAND REFORM WILL FOLLOW RELATIVE PRODUCTIVITY GAINS OF THE SMALL FARMER CLASS AND WILL HAVE TO WAIT FOR SUCH GAINS.

8 ON THE QUESTION OF JOB CREATION AND LABOR PRODUCTIVITY, ALTHOUGH ECUADOR HAS A LOW UNEMPLOYMENT RATE, IT IS GENERALLY AGREED THAT THERE IS A HIGH RATE OF DISGUISED UNEMPLOYMENT OR UNDEREMPLOYMENT. IT IS CLEAR THAT THERE ARE LARGE DIFFERENCES IN PRODUCTIVITY
CONFIDENTIAL

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PAGE 02 QUITO 08423 02 OF 03 021337Z

AND REMUNERATION AMONG WORKERS NOT EXPLAINED BY SKILL OR EDUCATION DIFFERENCES. THE URBAN UNDEREMPLOYED AND THE SUBSISTENCE FARMER GROUP, ESPECIALLY IN THE SIERRA, PROVIDE A VAST POOL OF LOW-COST, UNSKILLED LABOR.

9. IN THE FACTOR PROPORTION SENSE, AND DESPITE OIL REVENUES, INVESTMENT CAPITAL WILL REMAIN SCARCE RELATIVE TO LABOR FOR THE FORESEEABLE FUTURE. POLICIES CAN BE ADOPTED TO MAKE AND KEEP INVESTMENT RELATIVELY MORE LABOR INTENSIVE BUT SPREAD OVER ALL SECTORS OF THE ECONOMY. SUCH POLICIES COULD BE IMPLEMENTED THROUGH THE LEVEL AND STRUCTURE OF INTEREST RATES, THE RELATIVE INCIDENCE OF TAXES ON LABOR AND CAPITAL, AND THE USE OF TAX EXEMPTIONS AND IMPORT DUTIES TO STIMULATE INVESTMENT. EMPLOYMENT IN SUCH LABOR-INTENSIVE INDUSTRY, THROUGH NEITHER HIGH-WAGE NOR PRESTIGIOUS, WOULD BE EXTENSIVE IN QUANTITY AND THUS A SUBSTANTIAL IMPROVEMENT OVER THE SUBSISTENCE OR UNDEREMPLOYMENT SITUATION NOW WIDELY ENCOUNTERED.

10. WHILE THE DEVELOPMENT OF THE OIL AND GAS SECTOR IS A POWERFUL IMPETUS TO DEVELOPMENT THROUGH ITS IMPACT ON IMPORT CAPACITY, ECUADOREAN GOVERNMENT INVESTMENT OF ITS OWN FUNDS IN OIL/GAS IS A POOR POLICY CHOICE. SUCH INVESTMENT IS HIGH COST IN RELATION TO THE AVAILABLE INVESTMENT CAPITAL, AND THE EMPLOYMENT

GENERATED IS TRIVIAL IN RELATION TO THE NEED. RELATIVELY MINOR DOWNWARD ADJUSTMENTS IN THE TAX ON OIL PRODUCTION AND PROFITS (PLUS A MORE COOPERATIVE REGULATORY ATTITUDE) COULD RESTORE A FAVORABLE CLIMATE FOR FOREIGN INVESTMENT IN THIS AREA. THE INTERNATIONAL OIL COMPANIES HAVE THE EXPERTISE AND THE CAPITAL AS WELL AS THE WILLINGNESS TO INVEST. NO OTHER RESOURCE IN ECUADOR HAS ANYWHERE NEAR THE APPEAL FOR FOREIGN INVESTMENT. IT IS HARD TO OVEREMPHASIZE THE BENEFITS TO THIS ECONOMY OF THE RENT IT ENJOYS FROM FOREIGN PETROLEUM ACTIVITY IN THE FORM OF EXPORT EARNINGS AND GOVERNMENT REVENUE. BUT THIS RENT SHOULD BE INVESTED IN OTHER SECTORS, SUCH AS AGRICULTURE, EDUCATION, HEALTH AND LABOR INTENSIVE INDUSTRY RATHER THAN BACK

CONFIDENTIAL

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PAGE 03 QUITO 08423 02 OF 03 021337Z

INTO THE PETROLEUM SECTOR WHERE IT MERELY REPLACES FOREIGN CAPITAL IN A CAPITAL-INTENSIVE AND NON-PEOPLE-ORIENTED ACTIVITY.

11. THE EFFECT OF A POLICY OF ENCOURAGEMENT OF ADDITIONAL FOREIGN INVESTMENT IN OIL PRODUCTION COULD BE FELT QUICKLY IN THAT THE TEXACO-GULF CONCESSION AREA CONTAINS SEVERAL ADDITIONAL FIELDS OF PROVED RESERVES WHICH COULD BE PUT ON STREAM BY DRILLING AND MINIMUM CONNECTION TO EXISTING PIPELINE INFRASTRUCTURE. EXPLORATION AND DEVELOPMENT OF AREAS OUTSIDE THIS CONCESSION WILL, HOWEVER, REQUIRE A MUCH LONGER TIME.

12. ECUADOR HAS TRADITIONALLY RELIED ON TAX AND DUTY EXEMPTIONS ON CAPITAL INPUTS AS ITS PRIMARY INCENTIVE FOR INDUSTRIALIZATION. AMONG THE CRITERIA USED TO AWARE TAX/DUTY BENEFITS IS THE "MODERNITY" OF THE ENTERPRISE. AT THE SAME TIME, ECUADOR PLACES A RELATIVELY HIGH PAYROLL TAX BURDEN ON THE LABOR FACTOR IN ORDER TO PAY FOR SOCIAL SECURITY. CAPITAL USE IS FURTHER ENCOURAGED THROUGH THE IMPOSITION BY RESULTATION OF UNREALISTICALLY LOW INTEREST RATES (9-12 PERCENT IN A COUNTRY OF 15 PERCENT INFLATION). THESE TYPES OF POLICIES ARE REQUIRED FOR STIMULATION OF INVESTMENT IN A SITUATION OF AN OVERVALUED CURRENCY. THE RESULT IS, OF COURSE, A SHORTAGE OF LENDABLE CAPITAL AND OF FOREIGN EXCHANGE. (THE COUNTRY'S RELATIVELY STRONG FOREIGN EXCHANGE RESERVE POSITION AND CURRENT ACCOUNT SUPRLUS ARE MORE APPARENT THAN REAL. THEY ARE BEING PURCHASED AT THE COST OF A LOW LEVEL OF ECONOMIC ACTIVITY VIA IMPORT RESTRICTIONS AND SIMILAR DISTORTING POLICIES. INDEED, A COUNTRY AT ECUADOR'S STAGE OF DEVELOPMENT CANNOT AFFORD

A CURRENT ACCOUNT SURPLUS--WHICH MEANS THAT IT IS
"LENDING" RESOURCES ABROAD.

13. PREDICTIONS OF WHERE THE ECUADOREAN ECONOMY IS
GOING IN THE LONGER RUN ARE VERY HARD TO MAKE BECAUSE
OF THE WIDE RANGE OF CHANGES THAT CAN BE MADE IN THE
UNDERLYING STRUCTURE. THUS, RATHER THAN A SINGLE
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PAGE 04 QUITO 08423 02 OF 03 021337Z

PREDICTION, THE TWO TYPICAL OUTCOMES WILL BE INDICAT-
ED. NEITHER IS A STRAW MAN; YET THE OUTCOME WILL
ALMOST CERTAINLY BE SOMEWHERE BETWEEN THE TWO.

A. "THE PAST IS PROLOGUE."

(1) WHILE THE EXPORTING OF OIL AND THE REVENUES EARNED THEREBY, AND THE CONSTRUCTION OF THE PORT OF MANTA HAVE TOGETHER BROKEN THE PHYSICAL AND FINANCIAL STRANGLEHOLD OF GUAYAQUIL, THAT CITY STILL WIELDS SUBSTANTIAL POLITICAL AND ECONOMIC POWER, AND COMPETES FOR POWER WITH QUITO. THROUGH THE GUAYAQUIL-BASED IMPORTERS' REAL LONG-RUN INTERESTS ARE TO CONTINUALLY INCREASE IMPORT CAPACITY THROUGH EXPORT GROWTH, THEY REACT NEGATIVELY TO THE SHORT-RUN EFFECT OF CHANGES IN THE COMPOSITION OF IMPORTS IMPLIED BY EXPORT STIMULATION POLICIES. THEY ALSO TEND TO BELIEVE THAT THEY WILL BE ABLE TO "GET" THE FOREIGN EXCHANGE THEY NEED. EXPORTERS IN GENERAL ARE MORE DISPERSED AND THE POTENTIAL EXPORTERS OF NEW AGRICULTURAL ENTRIES ARE NOT EVEN IDENTIFIED. THE EXPORTERS OF BANANAS, CACAO, AND COFFEE ARE LESS WELL ORGANIZED THAN THE IMPORTERS, ARE OFTEN COMPETING WITH EACH OTHER AND ARE SATISFIED WITH SPECIAL ARRANGEMENTS FOR THEIR PRODUCT, SUCH AS TAX EXEMPTIONS, EXPORT SUBSIDIES, OR MOVEMENT OF THEIR EXPORT TRANSACTIONS TO THE "FREE" FOREIGN EXCHANGE MARKET.

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PAGE 01 QUITO 08423 03 OF 03 021346Z

53

ACTION ARA-10

INFO OCT-01 ISO-00 SP-02 USIA-06 AID-05 EB-07 NSC-05

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R 012237Z DEC 76

FM AMEMBASSY QUITO

TO SECSTATE WASHDC 2401

C O N F I D E N T I A L SECTION 3 OF 3 QUITO 8423

(2) THE CONCEPT OF A "HARD" SUCRE APPEALS NOT ONLY TO THE IMPORTERS BUT ALSO TO THE FINANCIAL CONSERVATIVES. EXCHANGE RATE STABILITY IS ONCE AGAIN THE FIRST OBJECT OF ECONOMIC POLICY (SEE PARA 5 ABOVE.) IF THIS CONTINUES TO BE THE CASE, WE PREDICT A DECLINE IN THE ECONOMIC GROWTH RATE TO ABOUT THE POPULATION GROWTH RATE. WE SPECULATE THAT HAVING TASTED THE JOYS OF A HIGH ECONOMIC GROWTH RATE FOR NEARLY A DECADE, THERE WILL BE CONSIDERABLE UNHAPPINESS RESULTING FROM THE RELATIVE STAGNATION. THE BLAME WILL HAVE TO BE PUT SOMEWHERE; IN THIS CASE, IT COULD WELL FALL ON PRIVATE ENTERPRISE FOR NOT RESPONDING TO ITS SOCIAL DUTY. THE RESULT COULD BE THAT THE GOE WILL ENCROACH ON SIGNIFICANT AREAS NORMALLY LEFT TO PRIVATE ENTERPRISE IN ORDER TO MAKE THEM MORE RESPONSIVE. LACK OF RURAL DISTRIBUTIONAL PROGRESS DUE TO INVESTMENT SHORTFALL MIGHT WELL CAUSE UNREST, LEADING TO A (SANCTIONED OR UNSANCTIONED) LAND REFORM BEFORE BETTER PRODUCTIVITY CONDITIONS ARE ACHIEVED, THUS SETTING THE STAGE

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PAGE 02 QUITO 08423 03 OF 03 021346Z

FOR WIDESPREAD INSTABILITY.

B. "THE BASIC LESSON IS LEARNED." A MORE OPTIMISTIC BUT STILL PLAUSIBLE PREDICTION IS THAT

THE DECADE OF DYNAMIC GROWTH AND THE CURRENT SLOWDOWN WILL HAVE TAUGHT THE ECUADOREANS THE LESSON OF THE BASIC ROLE OF THE EXTERNAL SECTOR. POLICIES WILL GRADUALLY BE CHANGED SO THAT DYNAMIC EXPORT AND IMPORT GROWTH WILL RESUME. AN INCREASE IN OIL (AND GAS) EXPORTS WOULD SEEM TO BE THE MOST LIKELY MEANS FOR THIS CONDITION TO BE ACHIEVED IN THE NEXT SEVERAL YEARS. A DEVALUATION OF THE SUCRE WOULD BE DESIRABLE TO STIMULATE OTHER EXPORTS, BUT A BIG ENOUGH INCREASE IN OIL EXPORTS PLUS A DOMESTIC MONETARY AND FISCAL POLICY THAT ELIMINATED INFLATION COULD CHANGE THE TERMS OF TRADE FOR AGRICULTURE IN THE RIGHT DIRECTION OVER THE NEXT DECADE. SUCH A GRADUAL SHIFT WOULD BE MORE IN ACCORDANCE WITH THE RIGIDITIES AND PROPENSITY FOR SLOW CHANGE INHERENT IN THE AGRICULTURAL SECTOR. A LESS THAN IDEAL BUT NEVERTHELESS EFFECTIVE CHANGE IN THE TERMS OF TRADE COULD BE ACHIEVED BY FURTHER INCREASES IN IMPORT DUTIES. SUBSIDIES BASED ON EXPORT VOLUME, NOT ON CAPITAL INPUT, COULD FOSTER ENTRY OF NEW PRODUCTS INTO WORLD MARKETS. WHILE THIS IS CLEARLY A SECOND-BEST TYPE OF DEVALUATION, IT MAY BE THE ONLY KIND OF DEVALUATION COMPATIBLE WITH EXPANDING OIL EXPORTS.

14. WE BELIEVE THAT THE INTERNATIONAL DONORS COULD AND MUST PLAY A LARGE ROLE IN MAKING THE OPTIMISTIC PREDICTION REAL. THERE IS A VERY DEFINITE REALIZATION BY THOUGHTFUL ECUADOREANS THAT A GOOD PORTION OF ECUADOR'S OIL INHERITANCE HAS BEEN SQUANDERED BUT THAT THERE IS STILL ENOUGH LEFT TO MAKE IT WORTHWHILE TO GET EXPERT POLICY AND INVESTMENT ADVICE FOR THE REMAINDER. THE GOE NEGOTIATIONS TOWARD A WORLD BANK-LED CONSULTATIVE GROUP MUST BE INTERPRETED IN THIS LIGHT. IF THE CONFIDENTIAL

CONFIDENTIAL

PAGE 03 QUITO 08423 03 OF 03 021346Z

SULTATIVE GROUP CAN RESULT IN CHANGES IN THE PARAMETERS DETERMINING THE FACTOR INTENSITY OF INVESTMENT AND THE RURAL/URBAN DISTRIBUTION OF THE BENEFITS OF GOVERNMENT SERVICES, AND IF THE CONSULTATIVE GROUP CAN ENCOURAGE NEW AGRICULTURAL EXPORTS IN AN ENVIRONMENT OF NO OR LITTLE INFLATION, THEN ECUADOR CAN CONTINUE ITS BOOMLET AND PROGRESS CAN BE MADE ON ITS DISTRIBUTIONAL PROBLEMS.

15. AS THE EMBASSY ARGUES IN REFTTEL, U.S. INTERESTS WOULD BE SERVED BY SUCH A PROGRAM, NOT ONLY OUR IN-

TERESTIN DEVELOPMENT PER SE, BUT ALSO OUR INTEREST
IN ECUADOR AS A MARKET FOR OUR EXPORTS AND IN THE
GREATER SUPPLY OF OIL AND (GENERALLY NON-COMPETING)
AGRICULTURAL PRODUCTS IN THE WORLD MARKET. FURTHER,
THE ECUADOR OF THIS ALTERNATIVE IS MUCH MORE COMPATIBLE
WITH OUT POLITICAL INTERESTS. IT WOULD BE BASICALLY A
MARKET ECONOMY IN WHICH INDIVIDUAL INITIATIVE AND THUS
FREEDOM IS PRIMARY. BY ITS ACTIVE AND SUCCESSFUL
PARTICIPATION IN THE WORLD MARKET, IT WOULD BE AWARE
OF AND RESPONSIBLE TO THE POLITICAL REQUIREMENTS OF
THE INTERDEPENDENCE OF NATIONS.
BLOOMFIELD

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